D.P.U. 95-67

Petition of New England Electric System, Nantucket Electric Company, and the Attorney General of the Commonwealth for Department approval of a comprehensive settlement of issues related to the proposed merger of Nantucket Electric Company into the New England Electric System, pursuant to G.L. c. 164, §§ 14, 15, 16, 17A, 72, 94, 94A, 96, and 97.

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I. INTRODUCTION

On May 26, 1995, pursuant to G.L. c. 164, §§ 14, 15, 16, 17A, 72, 94, 94A, 96, and 97, New England Electric System ("NEES" or "Company"), Nantucket Electric Company ("Nantucket"), and the Attorney General of the Commonwealth ("Attorney General")[1] filed with the Department of Public Utilities ("Department") a Joint Motion for Approval of Offer of Settlement ("Joint Motion"), an accompanying Offer of Settlement ("Settlement"),[2] a Merger Agreement by and among NEES, NEWCO,[3] and Nantucket ("Merger Agreement"), the prefiled testimony of John G. Cochrane, vice president and director of corporate finance for New England Power Service Company, a subsidiary of NEES, and the prefiled testimony of James E. Joynt, vice president and treasurer of Nantucket. According to the Joint Motion, the Settlement is intended to resolve all issues associated with acquisition of Nantucket by NEES. By letter dated July 17, 1995, NEES represented that the signatories to the Settlement agreed to extend the date for Department approval of the Offer of Settlement from August 1, 1995, to October 10, 1995. The Joint Motion, and the accompanying documents identified above, were docketed as D.P.U. 95-67.

Pursuant to notice duly issued, the Department conducted a public hearing in Nantucket on July 27, 1995, to afford interested persons an opportunity to be heard. Two days of

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1 We refer to NEES, Nantucket, and the Attorney General collectively as the "Parties". The Attorney General also intervened pursuant to G.L. c. 12, § 11E.

2 On July 24, 1995, NEES filed an amended Offer of Settlement which was identical to the filed Settlement but for the inclusion of Jane Walton as a signatory.

3 NEWCO is a to-be formed Massachusetts corporation wholly-owned by NEES which will merge with Nantucket to form the Surviving Corporation.

evidentiary hearings were held at the offices of the Department on August 2 and 3, 1995. Limited participant status was granted to Ross M. Donald of Boston and Jane Walton of Nantucket. The evidentiary record consists of 48 exhibits and twelve responses to record requests.

NEES is a registered holding company under the Public Utility Holding Company Act of 1935. Its present subsidiaries include three retail companies: Massachusetts Electric Company ("MECo"), which supplies retail electric service to approximately 950,000 customers in 149 cities and towns in Massachusetts, Granite State Electric Company, and Narragansett Electric Company; a service company, New England Power Service Company, and a wholesale electric generating and transmission company, New England Power Company ("NEP").

II. SUMMARY OF THE SETTLEMENT

The Settlement is intended to provide a comprehensive resolution of all issues associated with the acquisition of Nantucket by NEES (Joint Motion at 1). The Settlement incorporates the Merger Agreement and the prefiled testimony identified above (Settlement at 2). The Merger Agreement indicates that, following requisite government approvals, NEWCO would merge with Nantucket, and the surviving corporation ("Surviving Corporation") would become a wholly-owned subsidiary of NEES (id.).

Under a proposed Rate Plan established by the Merger Agreement and the Settlement, Nantucket customers will see a five percent reduction in their base rates upon consummation of the merger (Exhs. NEES-1, at 10; NEES-2, at 33). Upon the in-service date of the Nantucket Cable Project (the "Cable Facilities"), Nantucket customers will pay MECo rates plus a surcharge to cover the cost of the Cable Facilities (id.). According to the Merger Agreement and

Settlement, Nantucket rates in the first year after the in-service date of the Cable Facilities shall be no higher than the Nantucket rates in effect before the in-service date (Exhs. NEES-1, at 11; NEES-2, at 33).

Pursuant to the Settlement, the Parties agree that the merger of NEWCO and Nantucket and the terms of the Merger Agreement are consistent with the public interest under G.L. c. 164, § 96, and that the Surviving Corporation shall possess the rights and franchises to carry on its electric business on the Island of Nantucket (Settlement at 3). The Parties further agree that the Surviving Corporation's rate plan shall be as detailed as in Exhibit B of the Settlement and shall include the proposed accounting entries and treatment of environmental response costs (id.).

The Settlement further states that, pursuant to G.L. c. 164, § 17A, credit and operating support agreements with MECo provide a guarantee of payment of all interest, debt, contractual or other obligations undertaken by the Surviving Corporation not otherwise covered by the Surviving Corporation's utility operating revenues (id.). Such payments include a return on the Surviving Corporation's common equity equal to the return on equity last approved for MECo by the Department (id.). The parties further agree that, pursuant to G.L. c. 164, § 17A, the Surviving Corporation shall assume the liabilities of Nantucket, including the assumption of the Massachusetts Industrial Finance Agency ("MIFA") $3.5 million, 8.5 percent long-term note due March 2016, and the Bank of Boston Revolving Credit and Term Loan Agreement dated December 15, 1994 (id.). The Settlement also indicates that (1) the NEES Money Pool[4] shall be

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[4] The NEES Money Pool constitutes a cash management vehicle for certain of NEES's affiliates. Members of the Pool are allowed to draw on the Pool's short-term cash surpluses to meet short-term borrowing requirements. New England Power Company/Massachusetts Electric Company, D.P.U. 589 (1981); D.P.U. 589-A (1982);

amended to include the Surviving Corporation as both a borrower and investor under G.L. c. 164, § 17A (id. at 4); and (2) the financing arrangements of the Surviving Corporation for the Cable Facilities shall be approved under G.L. c. 164, §§ 14, 15, 15A, 16, and 17A (id.). Furthermore, the Settlement states that NEWCO and the Surviving Corporation shall issue common stock to NEES at a par value of $1.00, pursuant to G.L. c. 164, § 14 (id.).

According to the Settlement, the Parties propose that the Surviving Corporation shall purchase requirements power from NEP under G.L. c. 164, § 94A, and NEP shall purchase certain of the Surviving Corporation's generation facilities at book value, or assume existing leases for these facilities under G.L. c. 164, § 97 (id. at 3-4). If the Department finds that approval pursuant to G.L. c. 164, § 72, is necessary, the Parties state that the Cable Facilities will serve the public convenience and necessity and be consistent with the public interest (id. at 4).

Finally, the terms of the Settlement dictate that the Settlement establishes no precedent and shall not foreclose any party from making any contention in any future proceeding or investigation (id.). The Settlement also specifies that the Department's acceptance of the Settlement shall not constitute a determination by the Department as to the merits of any issue in any subsequent proceeding (id.).

III. STANDARD OF REVIEW

In assessing the reasonableness of an offer of settlement, the Department must review the entire record as presented in the filing and other record evidence to ensure that the settlement is consistent with Department precedent and the public interest and results in just and reasonable

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D.P.U. 589-B (1983).

rates. See Cambridge Electric Light Company/Commonwealth Electric Light Company, D.P.U. 87-2C at 9 (1995) (and companion cases); Western Massachusetts Electric Company, D.P.U. 88-8C at 15 (1994) (and companion cases); Colonial Gas Company, D.P.U. 93-78, at 6 (1993); Barnstable Water Company, D.P.U. 91-189, at 4 (1992); Western Massachusetts Electric Company, D.P.U. 92-13, at 7 (1992). In assessing the reasonableness of an offer of settlement, the Department must scrutinize the settlement agreement in light of the evidentiary record and then weigh the settlement against the probable outcome and resulting rates if the case were to follow the customary course to issuance of a final Department Order. Cambridge Electric Light Company, D.P.U. 87-2C at 9 (1995).

In order to assess the probable outcome of a merger review proceeding, the Department must apply the appropriate statutes and other precedent to the information available in the record. The Department's statutory authority for approving mergers and acquisitions is found in G.L. c. 164, § 96. Because the Settlement of the present case seeks several Department approvals pursuant to several statutory provisions, the Department also must apply the standards of review applicable to each approval, and ultimately must determine whether the plan of merger and Settlement are "consistent with the public interest." Id.

IV. SPECIFIC FINDINGS AND APPROVALS

A. Introduction

In this case, in addition to the approval of the merger pursuant to G.L. c. 164, § 96, the Settlement also requests the following specific Department findings and approvals regarding the

proposed transaction: (1) issuance of common stock by NEWCO and the Surviving Corporation to NEES pursuant to G.L. c. 164, § 14; (2) approval of the MIFA loan; (3) approval of the Surviving Corporation's assumption of the liabilities of Nantucket pursuant to G.L. c. 164, § 17A; (4) approval of the financing arrangements of the Surviving Corporation for the Cable Facility under G.L. c. 164, § 14, 15, 15A, 16, and 17A; (5) approval of credit and operating support agreements with MECo pursuant to G.L. c. 164, § 17A; (6) authority to make certain unit cost assumptions relative to Nantucket's plant accounting records; (7) a rate plan, as described above, pursuant to G.L. c. 164, § 94; (8) approval of the Surviving Corporation's purchase of requirements power from NEP pursuant to G.L. c. 164, § 94A; (9) a finding that the Cable Facility will serve the public convenience and be consistent with the public interest under G.L. c. 164, § 72, if such approval is deemed necessary; (10) NEP's purchase of certain of the Surviving Corporation's generation facilities at book value, or assumption of existing leases for these facilities under G.L. c. 164, § 97; and (11) confirmation of the rights and franchises of the Surviving Corporation to carry on its electric business on the Island of Nantucket. The Standards of Review applicable to each of the specific findings and approvals are discussed below.

B. Financing Approvals

1. Standard of Review

In order for the Department to approve the issuance of stock, bonds, coupon notes, or other types of long-term indebtedness by an electric or gas utility, the Department must determine

that the proposed issuance meets two tests under G.L. c. 164, § 14. First, the Department must assess whether the proposed issuance is reasonably necessary to accomplish some legitimate purpose in meeting a company's service obligation. Fitchburg Gas & Electric Light Company v. Department of Public Utilities, 395 Mass. 836, 842 (1985), citing Fitchburg Gas & Electric Light Company v. Department of Public Utilities, 394 Mass. 671, 678 (1985). Second, the Department must determine whether the company has met the net plant test.[5] Colonial Gas Company, D.P.U. 84-96 (1984).

In cases where no issue exists about the reasonableness of management decisions regarding the requested financing, the Department limits its Section 14 review to the facial reasonableness of the purpose to which the proceeds of the proposed issuance will be put. Canal Electric Company, et al., D.P.U. 84-152, at 20 (1984); see, e.g., Colonial Gas Company, D.P.U. 90-50, at 6 (1990).

Regarding the net plant test, a company is required to present evidence that its net utility plant (original cost of capitalizable plant, less accumulated depreciation) equals or exceeds its total capitalization (the sum of its long-term debt and its preferred and common stock outstanding) and will continue to do so following the proposed issuance. Colonial Gas Company, D.P.U. 84-96, at 5 (1984). If the Department determines at that time that the fair structural value of the plant and land and the fair value of the nuclear fuel, gas inventories, and fossil fuel inventories owned by such a utility are less than its outstanding stock and debt, it may prescribe such conditions and requirements as it deems best to make good within a reasonable time the

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[5] The net plant test is derived from G.L. c. 164, § 16.

impairment of the capital stock. G.L. c. 164, § 16.

Pursuant to G.L. c 164, § 15, an electric or gas company offering long-term bonds or notes in excess of $1 million in face amount must invite purchase proposals through newspaper advertisements. The Department may grant an exemption from this advertising requirement if the exemption is in the public interest. G.L. c. 164, § 15.

Pursuant to G.L. c. 164, § 15A, a company is required to sell long-term bonds, debentures, notes, or other evidence of indebtedness at no less than the par value unless sale at less than par value is found by the Department to be in the public interest. G.L. c. 164, § 15A; see, e.g., Boston Gas Company, D.P.U. 92-127, at 8 (1992); Boston Edison Company, D.P.U. 91-47, at 15 (1991).

Pursuant to G.L. c. 164, § 17A, no gas or electric company shall loan its funds to, guarantee or endorse the indebtedness of, or invest its funds in the stock, bonds, certificates of participation or other securities of any corporation, association, or trust unless the said loan, guaranty or endorsement, or investment is approved in writing by the Department as consistent with the public interest. Bay State Gas Company, D.P.U. 91-165, at 5-8 (1992).

Where issues concerning the prudence of a utility's capital financing have not been raised or adjudicated in a proceeding, the Department's decision in such a case does not represent a determination that any specific project is economically beneficial to a company or to its customers. In such circumstances, the Department's determination in its Order may not in any way be construed as ruling on the appropriate ratemaking treatment to be accorded any costs associated with the proposed financing. See, e.g., Boston Gas Company, D.P.U. 95-66, at 7

(1995).

2. Analysis and Findings

a. Chapter 164, § 14

i. Stock Issuances

The Parties are seeking approval under G.L. c. 164, § 14 for (1) the issuance of one share of common stock, with a par value of $1, by NEWCO; and (2) the issuance of one share of common stock, with a par value of $1, by the Surviving Corporation (Exh. NEES-1, at 26). Upon the formation of NEWCO as a subsidiary of NEES, NEWCO will issue one share of common stock, with a par value of $1 per share, to NEES in exchange for $10,000 (id. at 27; Tr. 1, at 76). Immediately after the merger of NEWCO with Nantucket, the NEWCO share will be cancelled and the Surviving Corporation will issue a new share to NEES at the same par value and price (Exh. NEES-1, at 27, exh. JGC-6).

To complete the merger, NEES proposes to issue up to 160,000 shares of common stock, with a par value of $1 per share, to be exchanged for Nantucket's common stock (Exh. DPU-6; Tr. 1, at 76).[6] The exact number of NEES shares to be exchanged will be determined based on the average high-low price reported for NEES stock for the ten consecutive trading days immediately preceding 20 days prior to the closing date of the merger (Exh. NEES-2, at 52; Tr. 1, at 77). The exchange price has been set at $125 per Nantucket share outstanding (Exh. NEES-2, at 52). Interest will accrue from the date the Merger Agreement was signed by the Parties to the

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[6] The NEES stock issue would require approval by the Securities and Exchange Commission (Exh. NEES-1, at 26-27). According to the Parties, NEES is not seeking any approvals in this proceeding (Exh. DPU-26).

closing date, based on the Bank of Boston's prime rate (id.; Tr. 1, at 76-77).

To effect the Merger Agreement, NEES intends to issue a sufficient number of its common shares to NEWCO for deposit with an exchange agent to be designated by NEWCO (Exhs. NEES-1, at 5; NEES-2, at 11). Upon NEWCO's merger with Nantucket, Nantucket's existing shareholders will have the obligation to send their stock certificates to the exchange agent in order to receive payment (Tr. 1, at 78).

The issuance of one share of common stock by NEWCO to NEES, and the issuance of one share of common stock by the Surviving Corporation to NEES, is required for the purpose of effecting the merger of Nantucket with NEES. Therefore, the Department finds, in accordance with G.L. c. 164, § 14, that the stock issuance is reasonably necessary on its face because it is necessary to accomplish the Surviving Company's service obligation. See Colonial Gas Company, D.P.U. 90-50, at 6; Canal Electric Company, et al., D.P.U. 84-152, at 20.

ii. Debt Issuances

As part of the financing for the Cable Facilities, the Parties are seeking approval under G.L. c. 164, § 14, of a loan agreement with MIFA for up to $28,000,000 (Exh. NEES-1, at 26-27). Under special state enabling legislation and federal tax laws, MIFA is authorized to directly issue tax-exempt private activity bonds ("PABs") on behalf of the Surviving Corporation, which are expressly payable from revenues of the Surviving Corporation (id. at 29; Exh. DPU-28). MIFA contemplates selling the PABs through competitive bidding, negotiation with underwriters, or through direct negotiations with investors (Exh. NEES-1, at 31). MIFA would lend the proceeds from the PABs to the Surviving Corporation in exchange for the Surviving

Corporation's promise of repayment (id. at 29).

In order to reimburse MIFA for the PABs, the Surviving Corporation would issue its own bonds ("New Bonds") with provisions that will be fixed at the time the terms of the PABs are established (id. at 31). The New Bonds would mature in not more than 40 years, and may be non-callable for all or a portion of their life (id. at 30). To allow for market conditions, the Parties request an interest rate ceiling of 10 percent on the New Bonds (id. at 32).[7]

The record demonstrates that the financing is essential for the purpose of constructing the Cable Facilities. Therefore, the Department finds that the debt issuance is reasonably necessary to accomplish the Surviving Company's service obligation in accordance with G.L. c. 164, § 14. With respect to the Parties' proposed 10 percent interest cap, we find that such a cap is reasonable to account for uncertainty in the financial markets and to prevent the need to refile with the Department or the Securities and Exchange Commission.

iii. Assumption of Nantucket Liabilities

The Parties seek approval under G.L. c. 164, § 14, of the assumption by the Surviving Corporation of Nantucket's liabilities, including a $3,500,000 long-term note issued under the aegis of MIFA and a revolving credit and term loan agreement, both of which were previously approved by the Department (id. at 9).[8] According to the Parties, the Surviving Corporation

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[7] The Parties stated that as of May 1, 1995, the Surviving Corporation could issue 30-year fixed rate New Bonds to back the PABs at an interest rate of approximately 7 percent (id. at 30).

[8] The MIFA note was approved in Nantucket Electric Company, D.P.U. 90-334 (1991), and the revolving term loan was approved in Nantucket Electric Company, D.P.U. 94-184 (1995).

(continued...)

would need either the Bank of Boston's approval to assume the MIFA note or may elect to pay off the Bank of Boston note (Exh. DPU-9; Tr. 1, at 81-82).

The record demonstrates that assumption of these liabilities is required under the purchase method being used to account for the merger (Exhs. NEES-1, at 15-16; Tr. 2, at 25). Therefore, the Department finds that the request is reasonably necessary to accomplish the Surviving Company's service obligation in accordance with G.L. c. 164, § 14.

b. Chapter 164, § 15

As part of the financing for the Cable Facilities, the Parties are seeking an exemption from the public auction provisions of G.L. c. 164, § 15, for both the PABs and the New Bonds (Exh. NEES-1, at 26). According to the Parties, MIFA contemplates selling the PABs through competitive bidding, negotiation with underwriters, or through direct negotiations with investors (id. at 31). The terms of the PABs and their sale shall be subject to the satisfaction of the Surviving Corporation, which expects to give written assurances to MIFA and the underwriters or purchasers (id.).

With respect to the New Bonds, the Parties stated that the MIFA loan agreement requires the Surviving Corporation to issue the New Bonds directly to the MIFA trustee as security for the PABs (id. at 32). Even if the New Bonds could be sold to the public, the Surviving Corporation stated it would desire the flexibility to respond to market changes (id.). It considers this flexibility essential to the effectiveness of negotiated or small offerings as proposed herein (id.).

(...continued)

We note that, under the regulations of MIFA, the Surviving Corporation is required to sell the New Bonds directly to MIFA's trustee (Exh. DPU-28). The record in this case demonstrates that the use of tax-exempt MIFA financing to construct the Cable Facilities will result in a lower cost of debt than would otherwise be available, thereby producing benefits to customers in the form of a lower cost of capital (Exh. NEES-1, at 29-30). Therefore, the Department finds that an exemption from the provisions of G.L. c. 164, § 15, is in the public interest.

c. Chapter 164, § 15A

As part of the financing for the Cable Facilities, the Parties are seeking authorization to issue debt at less than par value, if so required, for both the PABs and the New Bonds, pursuant to G.L. c. 164, § 15A (id. at 26-27). According to the Parties, underwriters may desire to receive their compensation in the form of a discount from face value (id. at 32).

The record evidence demonstrates that the bond underwriters may seek their compensation in the form of a discount from the New Bond's face value (id.). Under these conditions, a requirement that the New Bonds be priced at par value may make them difficult to market. The Department finds that the ability to issue debt securities below par value may enhance their marketability and favorably affect the cost of borrowing. Therefore, we find that an exemption from the requirements of G.L. c. 164, § 15A, is in the public interest. We also find it appropriate that any discount on such securities shall be amortized in accordance with the accounting rules and regulations set forth in the Federal Energy Regulatory Commission Uniform Chart of Accounts. Boston Edison Company, D.P.U. 91-47, at 15 (1991).

d. Chapter 164, § 16

As part of the financing for the Cable Facilities, the Parties are seeking an exemption from any obligations the Department may otherwise prescribe under G.L. c. 164, § 16, in its Order regarding the PABs and New Bonds (Exh. NEES-1, at 27). The Parties so request because the Surviving Corporation could meet the net plant test only if the estimated costs of the Cable Facilities were proformed on the balance sheets (id. at 33).

To the extent that the Surviving Corporation's capital stock is impaired as a result of not meeting the net plant test, the Parties request that the Department impose no special conditions on the Surviving Corporation (id.). According to the Parties, the purchasers of the PAB and New Bonds would be highly sophisticated investors whose purchase decisions would be based on the bond ratings (Tr. 2, at 29). Because MECo would be the guarantor of the bonds, purchasers would have the assurance that the bonds would be paid (id. at 29-30). This guarantee, the Parties opine, meets the intent of G.L. c. 164, § 16 (id.).

The record indicates that the Surviving Company's existing plant is insufficient to support the additional financing being sought for the Cable Facilities (Exh. NEES-1, at 33; Tr. 2, at 28-29). The Department finds that the anticipated completion of the Cable Facilities in the first quarter of 1997, along with MECo's role as guarantor of the bonds to be issued, provides sufficient assurance that the Surviving Company will remedy any failure to meet the net plant test and any resultant impairment to its capital structure. See Sheffield Water Company, D.P.U. 92-168, at 7 (1992). Therefore, the Department grants the Parties' request for an exemption from the requirements of the net plant test for the proposed financing.

e. Chapter 164, § 17A

NEES is seeking approval under G.L. c. 164, § 17A, of an amendment to the current terms of the NEES Money Pool, in order to include the Surviving Corporation as both a borrower and investor (Exh. NEES-1, at 9, 26, exh. JGC-4).

As part of the financing for the Cable Facilities, the Parties are also seeking approval under G.L. c. 164, § 17A, of MECo's guarantee of the financing for both the MIFA PABs and the Surviving Corporation's New Bonds (id. at 27).

The Parties are seeking approval under G.L. c. 164, § 17A, of a Credit and Operating Support Agreement ("Reimbursement Agreement") intended to assure that Nantucket would have sufficient revenues to meet the allowed rate of return without affecting the return on the Cable Facilities (id. at 9). Under the Reimbursement Agreement, MECo would reimburse Nantucket at the end of each fiscal quarter for the difference between Nantucket's actual net income and a level which would allow Nantucket to earn a return on common equity equal to that approved for MECo (id., exh. B, exh. JGC-2). The Parties intend to book any payments made by MECo under the Reimbursement Agreement as an expense to MECo and as revenue to the Surviving Corporation (Exh. DPU-39).

The record demonstrates that the Surviving Corporation's participation in the NEES Money Pool will facilitate its access to short-term funding (Exh. NEES-1, exh. JGC-4; Tr. 1, at 82). Therefore, the Department finds the request is consistent with the public interest.

The record in this case demonstrates that the structures of the Rate Plan and Reimbursement Agreement stand MECo behind the Surviving Corporation (Exh. NEES-1, exh. JGC-2). As an entity with a stronger credit rating than the Surviving Corporation, MECo's

guarantee facilitates the marketing of the required financing to potential investors (id., at 33). Therefore, the Department finds the request is consistent with the public interest.

The record in this case demonstrates that the Reimbursement Agreement provides a means by which the Surviving Corporation would be able to maintain its financial integrity in the event that its revenues were inadequate to meet its overall cost of service (Exh. NEES-1, exh. JGC-2). Therefore, the Department finds the request is consistent with the public interest. The Department's determination in this Order is in no way to be construed as a ruling relative to the appropriate ratemaking treatment to be accorded any reimbursements that may be paid by MECo, or any revenues received by the Surviving Corporation.

f. Nantucket Plant Accounting Records

According to the Parties, Nantucket's plant records do not provide the level of detail that is prescribed by the Federal Energy Regulatory Commission's Uniform System of Accounts (id., at 19; Tr. 2, at 27). By way of example, although Nantucket has maintained track of plant assets installed by year, it may not have segregated the related costs by the year of installation (Exh. DPU-13). Rather than perform detailed record-keeping research to bring Nantucket's books into compliance with accounting requirements, the Surviving Corporation requests permission to make reasonable estimates of unit cost breakdowns for those accounts where inadequate data exist (id.). The Surviving Corporation would not change the total plant investment recorded on its books (id.).

The record evidence demonstrates that Nantucket's current records do not include the level of detail required by accounting regulations. Furthermore, the lack of certain unit cost data

increases the difficulty in determining the value of certain plant assets for purposes of calculating depreciation (Tr. 2, at 27). The effort to rectify this lack of information would, even if successful, unduly delay completion of the proposed merger and the realization of its evident benefits to customers. Accordingly, the Department finds it appropriate to permit the Surviving Company to make unit cost assumptions for those plant accounts where adequate data are not readily available.

C. Rate Approvals

The Settlement specifies that the Department review its provisions under G.L. c. 164, §§ 94 and 94A.

1. G.L. c. 164, § 94

a. Description of the Proposal

The Parties request approval of a rate plan pursuant to G.L. c. 164, § 94. The rate plan consists of a five percent reduction to all of Nantucket's base rates from their current levels, to be effective on the closing date of the Merger Agreement (Exh. NEES-1, at 33). According to the terms of the proposed Merger Agreement, on or about the in-service date for the Cable Facilities, which the Parties expect to be March 1, 1997, Nantucket's rates will be set using Massachusetts Electric Company's rate tariffs plus a surcharge to cover the costs of the cable facilities (id.).[9,10]

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[9] NEES indicated that a fiber optic cable would be installed in conjunction with the Cable Facilities (Exhs. DPU-29; NEES-1, at 12). NEES plans to install a fiber optic capability in excess of its own needs, at a small incremental cost (id.). Excess fiber optic capacity would be offered for lease or sale to a communications company, with any resultant revenues amortized in a manner to offset cost impacts of the cable surcharge on Nantucket customers (id.).

(continued...)

Pursuant to the terms of the Merger Agreement, the cable facilities surcharge will be estimated annually based on estimated costs and kilowatthour sales that are reconciled to actual figures in the next annual cable facilities surcharge filing (id.). In addition, under the terms of the Merger Agreement, the cable facilities surcharge for the first year will be set at a level such that the average cents per kilowatthour ("KWH") that customers pay for electric service in each rate class, does not exceed the average cents per KWH of each rate class of the pre-cable rates (id.). Lastly, pursuant to the Merger Agreement, the cable facilities surcharge shall remain at this level for a period necessary to recover the current costs includable in the surcharge and any accumulated deficiency together with an overall rate of return on capital, as established by the Department for MECo in its most recent rate decision (id. at 34).

b. Analysis and Finding

In assessing the reasonableness of an offer of settlement, the Department must scrutinize the settlement agreement in light of the evidentiary record and then weigh the settlement against the probable outcome and resulting rates were the settlement not to be approved. See Commonwealth Electric Company, D.P.U. 87-2C at 9 (1995) (and companion cases); Western Massachusetts Electric Company, D.P.U. 88-8C at 15 (1994) (and companion cases). The record shows that the revenues Nantucket would collect as a result of the Merger Agreement are lower

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(...continued)

[10] NEES provided an overview of the demand-side management ("DSM") activities planned for Nantucket customers following the merger (RR-DPU-12, Attachment). NEES stated that, following the merger, DSM services provided to Nantucket customers would be substantially the same as those provided to MECo's mainland customers (id.). Further, following the in-service date of the Cable Facilities, Nantucket customers would be charged the same conservation cost factors as MECo customers in the same rate classes (id.).

than those offered by the cable project without the Merger Agreement (Exh. NEC-1, exh. JEJ-3). Nantucket stated "the rates customers would experience through the merger are even lower than those offered by the cable project without the merger" (Exh. NEC-1, exh. JEJ-1, at 3).

In addition, the Department reviewed customer bill impacts under two scenarios: (1) current Nantucket rates versus post-merger rates, and (2) post-merger rates versus estimated post cable rates (RR-DPU-2). The bill impacts show that all of Nantucket's customers should see a decrease in their electric bill, assuming no change in their usage pattern, during the period that the post-merger rates are effective (id.). Once the cable surcharge becomes effective the majority of Nantucket's customers will continue to see a rate decrease. However, some customers, specifically those on Rate G-1, may see a significant rate increase (id.).

The Department finds overall that the rate plan included in the Merger Agreement is beneficial to Nantucket's ratepayers because without the merger, rates to all of Nantucket's customers would most likely increase, whereas, under the Merger Agreement, the majority of Nantucket's customers will see a decrease in their electric bill. In addition, the Department finds no evidence that the rate plan included in the Merger Agreement will be harmful to MECo's current ratepayers. Accordingly, the Department finds the rate plan included in the Merger Agreement to be reasonable.

We emphasize that our approval extends only to the plan as described in the Settlement. We expressly are not approving specific rates, tariffs, or terms and conditions. According to the Merger Agreement, the cable surcharge will be set in a proceeding pursuant to G.L. c. 164. In its review of the cable surcharge, the Department will assess, among other things, whether the

surcharge comports with the Department's other requirements regarding rates and rate design.[11]

2. G.L. c. 164, § 94A

a. Description of the Proposal

Under the terms of the Settlement, the Parties have requested approval of Surviving Corporation's purchase of requirements power from New England Power ("NEP") under G.L. c. 164, § 94A (Exhs. NEES-1, at 8; NEES-2, at 3). NEES proposes to provide all-requirements service to the Surviving Corporation under NEP's Resale Tariff Number 1 ("Tariff 1") following commercial operation of the Cable Facilities (Exhs. NEES-1, at 18; DPU-22).[12] This arrangement would supersede in its entirety the existing Power Purchase Agreement ("PPA") between Nantucket and NEP, approved by the Department in Nantucket Electric Company, D.P.U. 94-114 (1995) (Exh. NEES-1, at 18).[13]

In support of the proposed Tariff 1 arrangement, NEES asserted that this arrangement has no direct effect on Nantucket customers following the merger (RR-DPU-10). NEES noted that following the merger, Nantucket customers would pay MECo rates plus a cable surcharge regardless of the Tariff 1 arrangement between Nantucket and NEP (id.). Nonetheless, NEES

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[11] For example, given the Department's rate design goal of continuity, the Department would have concern with the rate impacts associated with the G-1 cable surcharge rates which were filed for informational purposes. The Department will consider the aggregate of the cable surcharge, base rates, and any other charges in its analysis.

[12] NEES stated that Surviving Corporation's load is effectively treated as if the Surviving Corporation had been merged with MECo (Exh. NEES-1, at 18).

[13] NEES also stated that since the existing PPA had been approved by the Federal Energy Regulatory Commission ("FERC"), a request to terminate would be filed at FERC (RR-DPU-11).

provided an economic analysis indicating that costs under Tariff 1 were about $4.3 million dollars less than costs under the existing PPA, on a 20-year net present value basis (id., Attachment).

b. Analysis and Findings

G.L. c. 164, § 94A requires gas and electric companies to file for Department approval all contracts for the purchase of gas or electricity of a duration greater than a year. The Department has construed this statute to include a determination of whether the petitioner has demonstrated that the subject contracts are in the best interests of the petitioner's ratepayers, New England Power Company, et al., D.P.U. 1204 (1982), and whether the subject contracts are cost-effective, New England Hydro-Transmission Electric Company, Inc. and New England Power Company, D.P.U. 86-247 (1987). Nantucket Electric Company, D.P.U. 94-114, at 9-10 (1995).

The Parties support the Tariff 1 rates as necessary to consummate the proposed merger and satisfy the terms of the Settlement and Merger Agreement, objectives they maintain are consistent with the public interest. Additionally, the record demonstrates that Tariff 1 will provide lower long-term purchased power costs than Nantucket ratepayers would have received under contracts which the Department recently found to be cost-effective and in the best interests of Nantucket ratepayers.[14] Therefore, the Department finds the proposed all-requirements contract filed in this case to be cost-effective and in the best interest of Nantucket ratepayers and

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[14] In Nantucket Electric Company, D.P.U. 93-137 (1994), Nantucket agreed to pursue development of wind resources including establishment of a Wind Collaborative and issuance of a Request for Proposals ("RFP") for 2.5 MW of on-island wind generation. On June 15, 1995, the parties to the Wind Collaborative (i.e., Nantucket, the Attorney General, and the Conservation Law Foundation) notified the Department that they would submit the Wind RFP to the Department no later than the earlier of one hundred and twenty days after the filing the articles of merger with the Secretary of State, or June 30, 1996.

hereby approves it.

D. Other Approvals

1. G.L. c. 164, § 72

a. Description of the Requested Approval

By the terms of the Settlement, the Parties requested confirmation that the Cable Facilities would be deemed to serve the public convenience and necessity and be consistent with public interest, pursuant to G.L. c. 164, § 72, or in the alternative, obtain confirmation that no Department approval under this statute is necessary (Settlement at 4; Exhs. NEES-1, at 28-29; DPU-5; RR-DPU-1). NEES stated that the statute is unclear as to whether the Cable Facilities constitute jurisdictional transmission or non-jurisdictional distribution (Exh. NEES-1, at 28-29; RR-DPU-1). Nantucket separately issued an opinion stating that the Cable Facilities do not fall within the ambit of the statute because it will operate at a voltage below that used by transmission lines classified as jurisdictional under the Siting Statute, G.L. c. 164, § 69G, which, Nantucket maintains, should be read in harmony with G.L. c. 164, § 72 (RR-DPU-1, Nantucket Response). Nantucket also points out that for accounting purposes, NEES classifies as transmission those lines of 69 kilovolts ("kV") or greater, and the Cable Facilities would operate at 46kV or lower (id.). Finally, Nantucket contends that if the Cable Facilities were found to be subject to this statute, then minor distribution lines as small as 4kV would similarly fall under the statute, a result not intended by the statute (id.).[15]

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[15] By letter dated September 26, 1995, NEES filed a letter concurring with Nantucket's position that the Cable Facilities are distribution facilities and thus no further review under this statute is warranted.

b. Analysis and Findings

G.L. c. 164, § 72 states in pertinent part: "An electric company may petition the department for authority to construct and use or to continue to use as constructed or with altered construction a line for the transmission of electricity for distribution in some definite area ...." This statute also accords the Department with jurisdiction to review facilities for the "transmission of electricity for distribution" to "some definite area". Id. Regardless of its classification as a transmission or distribution line, the Cable Facilities have been approved by the Department in a recent proceeding in which the Department found a submarine cable between Nantucket Island and the mainland of Massachusetts to be the least-cost, most reliable, and least-environmental impact means to provide the Island's electricity requirements. Nantucket Electric Company, D.P.U 93-137 (1994). For purposes of this proceeding only, and in light of the history of recent cases involving Nantucket Electric Company and possible changes in the definitions of transmission and distribution facilities at the federal level, we find that the subject Cable Facilities are not subject to approval under G.L. c. 164, § 72 (Exh. NEES-1, at 29, ll. 1-5; NEES letter of 26 September 1995, at 2).[16] The Department may revisit this issue in an upcoming proceeding.

2. G.L. c. 164, § 97

a. Description of the Requested Approval

The Settlement requests Department approval, pursuant to G.L. c. 164, § 97, of NEP's

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[16] We note that the Federal Energy Regulatory Commission's Notice of Proposed Rulemaking, RM95-8-000 and RM94-7-000 provides a multi-factored analysis of transmission and distribution facilities.

purchase of certain generation facilities at book value or assumption of existing leases for these facilities, which will remain as backup generation after the Cable Facilities are placed in-service (Settlement at 3-4; Exh. NEES-1, at 8-9). NEES indicates that the approvals sought under this statute apply to Nantucket's generation Units 10 and 11 which will be transferred to NEP once the Cable Facilities are activated (RR-DPU-4). In addition, NEES states that the transmission lines of NEP will be "actually connected", within the meaning of the statute, to those of the Surviving Corporation through the transmission lines of other electric utilities. Moreover, NEES avers that no stockholder approval is required pursuant to the statute since the consideration paid for the diesels will be less than ten percent of the total net utility plant of either NEP or the Surviving Corporation (id.).

b. Analysis and Findings

Under G.L. c. 164, § 97, the Department may review and approve as "consistent with the public interest" certain purchases and sales of property of a company owning transmission lines which are "actually connected" to the lines of other electric utilities. The Department has approved an asset transfer under this statute between NEP and another NEES subsidiary. New England Electric Company, D.P.U. 90-296 (1991). The Department concurs with NEES that stockholder approval for this transaction is not necessary due to the ratio of consideration paid for the property to the net plant of the acquiring company. Because the generators will provide backup for the Cable Facilities, and because the statutory requirements associated with their purchase and sale are otherwise met, the Department approves the purchase and sale of Units 10 and 11 as consistent with the public interest.

V. G.L. c. 164, § 96, Rights and Franchises

A. Standard of Review

The Department's authority to review and approve mergers and acquisitions is found at G.L. c. 164, § 96, which requires the Department to find that mergers and acquisitions are "consistent with the public interest." In Mergers and Acquisitions, D.P.U. 93-167-A at 7-8 (1994), the Department stated that it would consider the gains and losses of the proposed transaction and the special factors of an individual proposal to determine whether it is consistent with the public interest. Id. at 9. The Department stated that in order to meet this consistency standard, the costs or disadvantages of a proposed merger must be accompanied by benefits that warrant their allowance. The Department also indicated that it would consider various factors in determining whether a proposed merger or acquisition is consistent with the public interest pursuant to G.L. c. 164, § 96, such as (1) impact on rates; (2) impact on the quality of service; (3) resulting net savings; (4) impact on competition; (5) the financial integrity of the post-merger entity; (6) fairness of the distribution of benefits resulting between shareholders and ratepayers; (7) societal costs, such as lost jobs; (8) impact on economic development; and (9) alternatives to the merger or acquisition.

B. Position of the Parties

The Parties maintain that the merger of NEWCO with Nantucket and the terms of the Merger Agreement are consistent with the public interest under G.L. c. 164, § 96 (Settlement at 3). In assessing the merger proposal in light of the criteria set forth in D.P.U. 93-167-A, NEES states that (1) current Nantucket customers will receive a five percent reduction in their base rates

upon the consummation of the merger; (2) on the in-service date of the Cable Facilities, Nantucket customers' rates will be set at that point and going forward at MECo's then-current rate schedules plus the Cable Facilities Surcharge; and (3) during the first year of the Cable Facilities' operation, the rates paid by the Surviving Corporation's customers will be no greater than the rates before the in-service date (Exh. NEES-1, at 20). The Company concludes that this rate plan will provide Nantucket customers with lower, more stable rates (id. at 21).

With respect to quality of service, NEES indicates that Nantucket's retail operations will be supervised by an executive at MECo and its generation facilities will be supervised by NEP personnel (id.). Asserting its reputation for quality and reliability of service, NEES maintains that current Nantucket customers should see overall improvement to quality of service (id.). Regarding savings from the proposed merger, the Company states that the merger is expected to realize savings due to reductions in outside vendor costs, economies of scale in fuel and materials procurement, automation or consolidation of support and administrative functions, and improved credit quality (id. at 22).

As to the proposed merger's impact on competition, NEES states that the proposed transaction should have no impact on competition in Massachusetts and, because of the Island's isolation and small size, the merger would not increase NEES's market power (id.). The Company points out that Nantucket's revenues and customers represent less than one percent of MECo's revenues and customers (id. at 23).

In addition, NEES maintains that the post-merger company will have far greater access to financial resources due to its affiliation with NEES, the Reimbursement Agreement with MECo,

membership in the NEES Money Pool, and access to NEES for equity capital (id.). NEES further maintains that the transaction results in a fair distribution of benefits between Nantucket's stockholders and ratepayers because ratepayers will receive lower, more stable rates, and stockholders will receive less than book value for their stock (id.).

NEES indicates that the proposed merger would provide societal benefits because MECo's settlement covering the cleanup of hazardous waste will apply to the Surviving Corporation, and those resources will be applied to remedy the environmental hazard associated with the former manufactured gas plant property on the Island (id. at 24). The Company states that all full-time non-union employees working for Nantucket as of June 30, 1994, will be retained by NEES for at least three years following the date of acquisition, and union employees will continue working under an existing collective bargaining agreement (id.). Regarding economic development, the Company contends that commercial customers will benefit from lower rates, a financially stronger utility, and greater reliability (id. at 25).

Finally, NEES states that, because of Nantucket's location and small size, there are no reasonable and cost-effective alternatives for Nantucket to obtain the benefits which could be achieved through the proposed merger (id.).

Nantucket concurs with NEES with respect to the proposed rate plan, the anticipated levels of future Nantucket rates and benefits to Nantucket's ratepayers, and the other benefits of the proposed merger, as outlined by NEES, above (Exh. NEC-1, exh. JEJ-1). Nantucket emphasizes that its affiliation with NEES would bring important benefits to Nantucket ratepayers due to NEES's engineering, financial, and operational skills (id. at 4-5).

Pursuant to the terms of the Settlement, the Parties require that the Department confirm that the Surviving Corporation shall possess such rights and franchises to carry on the electric business as are currently possessed by Nantucket (Settlement at 3). NEES and Nantucket point out that under the Merger Agreement, the Surviving Corporation inherits all the rights, privileges, immunities, and franchises of Nantucket (Exh. DPU-1). NEES and Nantucket state that under G.L. c. 164, § 96, the legislature allows for the transfer of an electric company's franchise from an existing company to the new entity created by a merger without the specific approval of the Legislature (id.). Thus, the Parties seek approval from the Department for Nantucket to convey to the Surviving Corporation its franchise rights upon the Department's finding, as required by the statute, that the merger is consistent with the public interest (id.).

C. Analysis and Findings

The record of this case demonstrates that, given the many benefits to be realized from its consummation, the proposed merger is consistent with the public interest. The uncontroverted evidence indicates that the proposed merger will benefit Nantucket ratepayers in each of the eight criteria specified above. In particular, the Department notes that the merger promises lower, more stable rates for Nantucket ratepayers, greater service reliability, lower operational and societal costs. We concur with the Parties that no alternatives to the merger appear nearly as likely to produce the benefits purported by the merger. In Mergers and Acquisitions, D.P.U. 93-137-A at 5 (1994), the Department anticipated that changes in the electricity and gas markets portended a movement towards consolidation. The Department finds that the instant merger is

one which would "promote efficiency by discouraging waste, increasing productivity, and improving service reliability in order to lower costs for all customers" (id.). Therefore, we conclude that proposed merger is consistent with the public interest pursuant to G.L. c. 164, § 96 and hereby approve the Settlement.

In reaching this conclusion, the Department approves: (1) the issuances of common stock by NEWCO and the Surviving Corporation to NEES pursuant to G.L. c. 164, § 14; (2) the MIFA loan; (3) the Surviving Corporation's assumption of the liabilities of Nantucket pursuant to G.L. c. 164, § 17A; (4) the financing arrangements of the Surviving Corporation for the Cable Facility under G.L. c. 164, § 14, 15, 15A, 16, and 17A; (5) the credit and operating support agreements with MECo pursuant to G.L. c. 164, § 17A; (6) NEES' request to make certain unit cost assumptions relative to Nantucket's plant accounting records; (7) the Rate Plan, as described above, pursuant to G.L. c. 164, § 94; (8) the Surviving Corporation's purchase of requirements power from NEP pursuant to G.L. c. 164, § 94A; (9) NEP's purchase of certain of the Surviving Corporation's generation facilities at book value, or assumption of existing leases for these facilities under G.L. c. 164, § 97. We also find that no Department approval of the Cable Facilities is required under G.L. c. 164, § 72. Additionally, we find that the subject filing comports with the Department's Standard of Review for offers of settlement, as set forth in Section III, above, because it satisfies the Department's precedent governing mergers and acquisitions, provides an acceptable plan for rates, and is consistent with the public interest under this standard.[17]

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[17] We emphasize that this Order makes no findings on any rates charged or to be charged to

(continued...)

In finding that the proposed merger is consistent with the public interest, the Department also confirms to NEES and Nantucket that, pursuant to the terms of the Merger Agreement, the acquiring company receives all such rights and franchises as the acquired company had, to the extent those rights may be conveyed by the Department under its G.L. c. 164, § 96, authority, and the Department finds that further action of the Commonwealth of Massachusetts is not required to consummate the merger.

In accordance with the terms of the Settlement, our acceptance of the Settlement does not constitute a determination as to the merits of any allegations, contentions, or arguments made in this investigation. Finally, we note that our acceptance of the Settlement does not set any precedent whatsoever for future merger, acquisition, or other proceedings whether ultimately settled or adjudicated.

VI. ORDER

After due notice, hearing, and consideration, the Department

FINDS: That the Offer of Settlement meets the statutory requirements of G.L. c. 164, §§ 14, 15, 15A, 16, 17, 72, 94, 94A, 96, and 97; and it is

ORDERED: That the Joint Motion for Approval of Offer of Settlement, filed on May 26, 1995 and amended on July 17, 1995 by New England Electric Service, Nantucket Electric Company, the Attorney General of the Commonwealth, and Jane Walton, be and hereby is

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(...continued)

Nantucket's ratepayers on or around the in-service date of the Cable Facilities. Our approval extends to a plan to assess a Cable Facilities Surcharge upon MECo's base rates, and the immediate five percent rate reduction to Nantucket's ratepayers upon consummation of the subject merger.

granted; and it is

FURTHER ORDERED: That New England Electric System shall file for approval with the Department under G.L. c. 164, § 94, the tariffs, rates, and charges applicable to the provision of electric service on Nantucket Island; and it is

FURTHER ORDERED: That the Surviving Corporation shall possess any rights and franchises to carry on the electric business heretofore possessed and carried on by Nantucket Electric Company; and it is

FURTHER ORDERED: That a copy of the journal entries, or schedule summarizing such entries, recording the effect of the merger shall be filed with the Department upon completion of the merger; and it is

FURTHER ORDERED: That the Secretary of the Department within three days of the date of this Order shall cause to be delivered a copy of this Order on the Secretary of State of the Commonwealth and upon the Board of Selectmen of the Town of Nantucket.

By Order of the Department,

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Mary Clark Webster, Commissioner

_____

Janet Gail Besser, Commissioner

Appeal as to matters of law from any final decision, order or ruling of the Commission may be taken to the Supreme Judicial Court by an aggrieved party in interest by the filing of a written petition praying that the Order of the Commission be modified or set aside in whole or in part.

Such petition for appeal shall be filed with the Secretary of the Commission within twenty days after the date of service of the decision, order or ruling of the Commission, or within such further time as the Commission may allow upon request filed prior to the expiration of twenty days after the date of service of said decision, order or ruling. Within ten days after such petition has been filed, the appealing party shall enter the appeal in the Supreme Judicial Court sitting in Suffolk County by filing a copy thereof with the Clerk of said Court. (Sec. 5, Chapter 25, G.L. Ter. Ed., as most recently amended by Chapter 485 of the Acts of 1971).